

STOKES
BARTHOLOMEW
EVANS & PETREE

A PROFESSIONAL ASSOCIATION

NASHVILLE • MEMPHIS • MUSIC ROW

424 CHURCH STREET, SUITE 2800
NASHVILLE, TENNESSEE 37219-2386
(615) 259-1450 • FAX: (615) 259-1470
www.stokesbartholomew.com

GUILFORD F. THORNTON, JR.
gthornton@stokesbartholomew.com

RECEIVED

2003 APR 28 PM 2:13

T.R.A. DOCKET ROOM

Direct Dial: 615/259-1492
Direct Fax: 615/687-1507

April 28, 2003

The Honorable Sara Kyle, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

RE: Petition of Citizens Telecommunications Company of Tennessee LLC for
exemption under Tenn. Code Ann. 65-5-208(c)

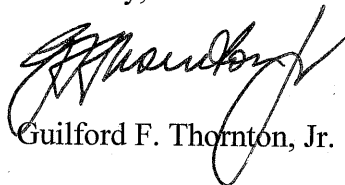
Docket No. 03-00211

Dear Chairman Kyle:

On behalf of Citizens Telecommunications Company of Tennessee, LLC ("Citizens"), I am enclosing with this letter an original and 13 copies of Citizens' responses to questions posed by the Authority in a letter from Aster Adams dated April 16, 2003.

Should you have any questions or require anything further at this time, please do not hesitate to contact me.

Sincerely,



Guilford F. Thornton, Jr.

cc: Aster Adams, Chief, Economic Analysis Division
Mike Swatts
Gregg Sayre

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

**IN RE: PETITION OF CITIZENS TELECOMMUNICATIONS COMPANY OF
TENNESSEE, LLC, FOR EXEMPTION UNDER TENN. CODE ANN. 65-5-208(c)**

DOCKET NO. 03-00211

RESPONSES TO TRA STAFF QUESTIONS

Citizens Telecommunications Company of Tennessee, LLC ("Citizens"), by and through its undersigned counsel, files these responses to questions previously tendered by staff of the Authority in this matter

1) Which services do you request to be exempted from the statutory price floor?

All services should be exempt because of the highly competitive nature of our business in McMinnville and Sparta. Our primary interest is business and residence access line service. However, the market should drive rates for all services rather than dated regulatory methodologies.

2) For each service listed in response #1, indicate whether the service is competitive. Please provide analysis to support the conclusion that a service is competitive.

Our petition clearly demonstrates the magnitude of loss we have experienced in McMinnville and Sparta. The fact that Ben Lomand Communications ("BLC") has taken a large portion of our customer base and is providing all telecommunications services to those customers is evidence that every service is competitive. Severe market loss is a clear indicator that competition exists. When a competitor takes away basic residential and business access line customers, that situation makes all other services competitive by definition because they depend upon the basic access line.

3) For each service listed in response #1, indicate if and how much the current tariff rate for the service can be lowered without violating the statutory price floor.

This questions call for Citizens to divulge sensitive data concerning its costs. Citizens is prepared to respond, upon the entry of an appropriate protective order by the Authority in this matter.

4) Provide justifications other than the presence of competition to support your petition. Specifically address the issue of public interest as a justification for exemption for the statutory price floor.

The statutory price floor was established to prevent incumbent LECs from lowering rates to the point CLECs could not compete. In other words, the price floor was designed to protect against predatory pricing, which as explained below in response to Question 5 is impossible under the conditions that now apply in McMinnville and Sparta. Conversely, the ability for a local exchange company to file for an exemption from the statutory price floor was also provided for a purpose, to prevent a lightly regulated CLEC from establishing rates that establish barriers for the LEC to be competitive. That is the very situation in McMinnville and Sparta. BLC, a subsidiary of a well-funded, highly-subsidized, lightly-regulated cooperative, is not bound by price floors or the regulatory review of special promotions as is Citizens.

It is not merely the presence of competition that Citizens is relying upon; it is the impact of the additional competition that granting Citizens' petition will stimulate that creates public interest benefits, and the absence of Citizens' ability to engage in effective competition that creates public interest detriments. Granting this exemption is clearly in the public interest. First of all, the customer directly benefits from the resulting lower prices. Also, if Citizens continues to be restricted in how it prices services then it will continue to lose significant market share. If that trend is not reversed, Citizens will be forced to make up those large losses in revenue from our remaining customer base in the form of rate increases, which is clearly not in the public interest. Conversely, if we are granted to ability to price competitively then we can retain and possibly win back customers.

It is also contrary to the public interest in a competitive situation to hold only one competitor's prices at an arbitrary minimum level. Economic theory holds that in the case of perfect competition, prices tend toward short-run, not long-run, marginal costs. If there are only two competitors and one competitor's prices are artificially propped up above short-run marginal costs, the other competitor can and will take advantage of "umbrella" pricing because it has no need to reduce prices more than a very short distance below the competitor's umbrella. This situation denies the benefits of competition to consumers and is contrary to the public interest.

5) Would granting the petition result in predatory pricing of services listed in the response to Question 1? If not, provide analysis to support this conclusion. What relationship, if any, exists between the relief requested in the petition and the allegations of predatory pricing pending in docket 02-01221?

No. This exemption has nothing to do with predatory pricing. It, however, does go to the heart of competitive pricing. It is important to note that if Citizens does not provide the

customer dial tone, then Citizens cannot sell them any vertical or advanced services. Our ability to price dial tone service below the statutory price floor provides us the ability to establish the "gateway" with that customer which is absolutely essential in order to offer a full panoply of ancillary and enhanced services. In competitive situations, it is often necessary to develop "loss leaders" or critical services priced at or below costs in order to have the ability to attract and provide the more profitable services customers demand. Such pricing can be seen every day in competitive industries. Although the competitive market cannot be fully predicted, the dial tone line is likely to be our "loss leader". Without competitive dial tone service rates we have no competitive chance.

In addition, it is impossible to engage in predatory pricing unless two conditions are met: (1) there must be a reasonable expectation that predatory pricing will drive the competitor out of the market; and (2) there must be a further expectation that prices could thereafter be raised to monopoly levels. Neither condition is met in this situation. BLC has already sunk its investment in outside plant in McMinnville and Sparta. Reducing prices below the statutory floor will not cause BLC to abandon its plant. Instead, the only reasonable expectation is that BLC will itself continue to compete – possibly through price drops of its own, or possibly through the introduction of new services, both of which would benefit consumers. Even making the unreasonable assumption that BLC would abandon its investment, it would be impossible for Citizens to complete the second half of the predatory pricing equation and raise prices to monopoly levels. If Citizens raised prices to such levels, BLC without significant cost could and would reenter the market.

6) Discuss why Citizens has opted to request a waiver of the statutory price floor instead of continued use of promotional offerings or offering bundles of products and services. Please include a comparison of the costs versus benefits of each competitive response considered relative to waiving the price floor requirements.

Promotional offerings are designed and even required by the TRA to be short term in duration. Continual use of special promotions in a competitive situation is ineffective and inefficient. Each promotion has to be designed, approved, marketed and monitored which is a drain on human and financial resources. Moreover, because a promotional offering is a short-term offering, it must be advertised as such. A short-term promotional price cannot compete with a long-term similar price offered by a competitor.

Bundling of products can be effective but is not appealing to the majority of customers and bundles alone are not attractive in a highly competitive situation where the competition can lure customers to their network through low dial tone rates. In a competitive situation there must be a level playing field where all parties compete on equal footing. Consumers are reluctant to accept bundles that may include more features or services than they need. BLC is not requiring its customers to accept bundles. Any regulatory barriers on a single party can be devastating.

In summary, promotional and bundled offerings cost more to the company and offer less to the consumer than long-term prices offered by a competitor on an a la carte basis. Our competitor does not need to rely upon these mechanisms to attract customers. Therefore, in order to be attractive, promotional prices and bundles must be established at significantly lower price levels than the long-term a la carte prices offered by BLC. Citizens would therefore be unfairly and uneconomically faced with both lower revenues and higher costs than its competitor, which is free to set long-term a la carte prices regardless of the statutory price floor.

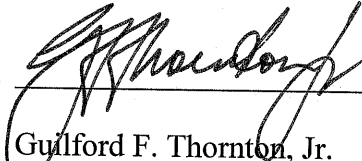
7) If the price floor waiver is approved, demonstrate how Citizens will recover revenues lost due to below cost pricing.

Citizens will recover some of the revenues lost to below cost pricing by establishing that critical "gateway" to the customer so enhanced services, DSL, Internet, voice mail, long distance and many other demand services which are priced above costs can be sold. If the price floor is not removed, Citizens will continue to see a rapid erosion of revenues which will result in filing for rate relief which is not in anyone's best interest.

Ultimately, however, it cannot be guaranteed that Citizens will make up all the lost revenues. That is the nature of competition. Citizens and the Authority are faced with a choice in this situation – the certainty of losing all of the revenues from most of Citizens' McMinnville and Sparta customers, versus the possibility of losing only some of the revenues by allowing Citizens the ability to compete on a level playing field with BLC. If Citizens loses all of the revenues from most of its customers in McMinnville and Sparta, it is far more likely that Citizens will be compelled to seek recovery of its loss from its customers in other areas.

Citizens may not be able to recover the bulk of any revenues lost to competition. The loss of cash flows will directly reduce the ability of the firm to meet the capital expenditures necessary to support the existing infrastructure of its telecommunications network and the ability to introduce new technology in the form of new and enhanced products and services to customers in a timely manner. In addition, the cost of any stranded investment in telecommunications plant may result in higher embedded loop costs over the Company's remaining access lines and possibly a long-term financial impact on the costs associated with the Federal Universal Service High Cost Fund.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "G. Thornton, Jr.", is written over a horizontal line.

Guilford F. Thornton, Jr.
Stokes Bartholomew Evans & Petree, P.A.
414 Church Street, Suite 2800
Nashville, TN 37219
615/259-1492

*Counsel for Citizens Telecommunications Company of
Tennessee, LLC*